

Commission on Health and Safety and Workers' Compensation

MINUTES OF MEETING

February 8, 2002

**Public Utilities Commission Building
San Francisco, California**

In Attendance

Chair Tom Rankin

Commissioners Allen L. Davenport, Jill A. Dulich, Leonard C. McLeod, Kristen Schwenkmeyer, Robert B. Steinberg, and John C. Wilson
Executive Officer Christine Baker

Absent

Commissioner Darrel "Shorty" Thacker

Call to Order: Approval of December 14, 2001 Meeting Minutes

Chairman Tom Rankin called the meeting to order at 10:05am and asked for a motion on the December 14, 2001 meeting minutes. Commissioner Wilson moved to approve the minutes, Commissioner Schwenkmeyer seconded and the motion passed unanimously.

State of the California Insurance Industry

At the invitation of the Commission, several representatives from throughout the workers' compensation community shared their perspective on the state of the workers' compensation industry in California. Ms. Baker introduced the speakers who proceeded to share their views on the subject.

J. Michael Nolan, President of the California Workers' Compensation Institute (CWCI)

Mr. Nolan set the stage for the hearing noting that there are diverse opinions about the issues to be addressed at the Commission meeting regarding the state of the insurance industry. In setting the framework for the hearing, Mr. Nolan summarized the positions of the various stakeholders with regard to the workers' compensation system commenting that the speakers who will follow will be speaking from their various perspectives on the topic.

Mr. Nolan then proceeded to make several points regarding current dynamics in the workers' compensation insurance market. First, he noted that the September 11 World Trade Center attack resulted in increasing re-insurance rates for carriers adding to the upward pricing pressure that employers already experienced and affecting the availability of insurance for employers. Also, primary workers' compensation carriers with post-9/11 re-insurance treaties now have no re-insurance protection for terrorist acts. He mentioned that at the present time insurers are faced with the issue of how to write insurance for terrorism.

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Mr. Nolan also noted that with the increase in rates and a possible reduction in availability of insurance, employers are expected to increase the use of a variety of approaches to reduce their workers' compensation costs such as greater use of self-insurance. He commented that this could present various regulatory oversight issues while regulatory budgets are declining.

Mr. Nolan emphasized that one of the crucial issues facing California is the economic viability of the California Insurance Guarantee Association (CIGA), which is the second-largest workers' compensation payer in the state, but is currently insolvent on a book-basis.

Commissioner Davenport commented that it would be of great concern if insurers decided not to insure for catastrophic acts such as terrorism, and asked if Mr. Nolan knew what insurance mechanisms are employed in other countries where terrorism is more routine. Mr. Nolan replied that in California workers' compensation the primary carrier does not exclude such coverage for its employer.

Mark Webb of the American Insurance Association added that the Association is asking Congress to approve an Act modeled after a mechanism in the United Kingdom. If passed, the Act would provide a certain level of retention by the private marketplace, but also have a catastrophic layer of coverage provided by the federal government.

Mark Webb, Vice-President of State Affairs for the American Insurance Association (AIA)

Mr. Webb addressed the causes of the drop in premiums after open rating came into effect in 1995. He emphasized that this decline was partly caused by an infusion of capital. The existence of large amount of available capital in the insurance industry was due to the precipitous drops in claim frequencies. Other sources of capital came from managed care and availability of relatively inexpensive reinsurance.

Mr. Webb also expressed the opinion that the California Department of Insurance should be given the appropriate tools to determine if rates are inadequate.

Mr. Webb suggested that CHSWC should not only look at whether there should be an exclusive state fund, but whether there should be an exclusive state fund at all. Mr. Webb expressed concern over the possibility of adopting an exclusive state fund in California due to political pressures that exclusive state funds are subject to.

Commissioner Steinberg asked how serious is the problem now of maintaining an adequate private insurance market in California. Mr. Webb replied that the current administration of the Department of Insurance takes a serious role in dealing with the crisis of insolvencies and that, in his opinion, the worst of the crisis is over. However, the increase in the cost of reinsurance and increase in benefit costs from pending legislation AB 749 could make the situation difficult for insurers. He also commented that the pending legislation which would extend the current level of surcharge by CIGA beyond the sunset date will help the insurance market move in the right direction.

Commissioner Rankin asked if the insurance market is still competitive although there are less insurance companies now after the open-rating law. Mr. Webb replied that this depends on the

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definition of a competitive insurance market. In his opinion, California still has one of the most competitive workers' compensation insurance marketplace based on traditional insurance measurements of market concentration. He also noted that largely the domestic industry has left the market, but there are still national companies in the insurance market that are developing capital in California.

Larry Mulryan, Executive Director of the California Insurance Guarantee Association (CIGA)

Mr. Mulryan explained that the California Insurance Guarantee Association (CIGA) is an association of property and casualty insurers that was created in 1969 to pay claim liabilities in the event insurers became insolvent. In the case of workers' compensation insurers CIGA has to pay 100% of the benefits. CIGA assures payment of liabilities through assessments levied against member companies, through distributions from the estates of the insolvent insurers and investment income.

Mr. Mulryan stated that CIGA in the 32 years since its creation, has paid out an average of \$51 million in claims every year. However, since September 2000 it has paid out \$600 million just for the Superior National insolvencies alone. Since then there were additional insolvencies including Reliance, Sable Insurance Company, and Credit General, which have put large financial demands on CIGA.

Mr. Mulryan noted that in order to help meet its financial demands CIGA obtained an increase in its premium assessment cap from 1% to 2% last year. However, he emphasized that in order to continue meeting its financial demands, CIGA needs to have the 2% surcharge reinstated beyond the current sunset date and to have a regular flow of disbursements from the estates. Currently, CIGA has not been receiving distributions from Superior National Insurance Companies, because a large part of the companies' reinsurances was tied up in one treaty currently in dispute. With the extension and the current rate of payouts, CIGA projects that by the end of calendar year 2002 it will be \$219 million in the negative in workers' compensation on a cash basis. By the end of 2005, CIGA expects to be in the black by \$10 million dollars. He stated that the Department of Insurance is working to assist CIGA in meeting claim obligations through helping to resolve reinsurance disputes.

Commissioner Davenport asked if there has been any criminal prosecution of any of the insurance companies that have gone insolvent since it seems that insurance companies sold policies whose costs they could not cover? Mr. Mulryan replied that he has no knowledge of fraud in any of the companies that CIGA has taken over. In his opinion, management charged too little in order to gain market share so as to stay in business longer.

Commissioner Wilson asked whether CIGA is a public agency. Mr. Mulryan replied that CIGA is a semi-public agency with private employees and a board of directors. However, CIGA also was created by statute and has to meet statutory obligations.

Commissioner Rankin asked if anything could be done at the state legislation level to help continue distribution from the estates or does this pertain to federal bankruptcy law. Mr. Mulryan replied that changing the current deposit law would help in solving the problem of distribution of the estates. At the present time, insurance companies securities are not directly

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deposited into CIGA which has created a hold up of the deposits. Mr. Mulryan further explained that many companies converted their securities into sureties when faced with problems. As the insurance companies became insolvent, the sureties have found various reasons not to pay obligations and CIGA does not receive money. He commented that the law should be simplified to allow CIGA to receive the deposits directly. This is being introduced into legislation this year.

David Bellusci, Vice President and Chief Actuary of the Workers' Compensation Insurance Rating Bureau of California

Mr. Bellusci made a presentation on Workers' Compensation Insurer Results. He pointed out several indicators that have had an impact on the financial difficulties that insurance companies have been experiencing. He noted that although indemnity claim frequency has been decreasing, the cost of an average indemnity claim has increased. The combined loss and expense ratios show that since open rating took effect in 1995 insurers are paying out substantially more than they are receiving in premiums. Mr. Bellusci further noted that the market share for California workers' compensation (excluding State Fund) insurers between 1994 and 2001 has declined substantially while State Fund's share has grown. However, Mr. Bellusci noted that while many companies have left the market, many other ones have entered.

Mr. Bellusci commented that the WCIRB's projections for the future include: a continued increase in insurance prices, continuing growth of the State Fund's market share, and a possibility of new entrants into the market attracted by higher rates.

Commissioner Rankin asked what would have happened if the insurance companies followed the advisory rates that the Insurance Commissioner recommended. Mr. Bellusci responded that the situation would not have been as bad as it is in the present time. He noted that the Commissioner provides advice only on loss costs. The insurers should have been charging 20 to 25 percent above loss costs to take into account other financial expenses. Instead, the insurers discounted significantly from loss costs which led to some of the current problems in the insurance industry.

Norris Clark, Chief of the Financial Surveillance Branch of the California Department of Insurance

Mr. Clark commented on the financial state of the industry. Mr. Clark noted that at the present time there are several financially troubled companies and very little new capital entering the market place. He pointed out that most of the business has been increasingly going to fewer insurance groups and that there is diminishing competition in the marketplace.

Larry White, Senior Staff Counsel, California Department of Insurance

Mr. White commented on the deregulation of the state of the insurance industry. He emphasized that the cause of the current financial situation of the insurance companies is open rating.

He noted that the law was changed under deregulation from "rates should be adequate for all admitted insurers" (under Minimum Rate Law) to rates shall not tend to impair or threaten the

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solvency of an insurer.” Mr. White noted that the change in the law meant that CDI could intervene only if a company’s solvency was impaired even if the insurer was losing money on its workers’ compensation rates. Also, in the Minimum Rate law only the workers’ compensation experience of a company could be used to judge the adequacy of rates. After the new law was enacted in 1993, only if the workers’ compensation rates of a particular company would cause that company to be insolvent, for the entire company book of business, could CDI intervene.

He further stated that the Insurance Commissioner needed some authority to have an effect on the insurance market. Currently, the Insurance Commissioner has financial solvency authority over companies, but no authority over the market as a whole.

Commissioner Steinberg asked what standard CDI employs to trigger conservatorship of a company. Mr. Clark replied the standard includes failure to provide the books and records for examination, operating in financially hazardous conditions or being found to be insolvent (when a company’s minimum capital requirement is impaired).

Commissioner Steinberg asked what the Department of Insurance need to do to avoid insolvencies seen in the past. Mr. Clark replied that a suggestion was made to move away from the standard of impairing insolvency discussed above to a rate adequacy standard. The rate adequacy standard looks at the California workers’ compensation business and the losses associated with that business. The Insurance Commissioner could then regulate the rate to cover business losses and expenses taking into consideration investment income.

Pat Quintana, Government Relations Officer for the State Compensation Insurance Fund

Ms. Quintana conducted some historical research for the presentation at the meeting. She commented that some remarks at the meeting pointed out that the current state of the industry today relates to open rating. However, her research shows that under the no open rating laws in 1915 there were companies that had also gone into liquidation while State Fund had prospered. Ms. Quintana also proceeded to make remarks about the history and mission of State Fund. She stated that the State Fund was created 88 years ago under Governor Johnson. Governor Johnson declared that the Fund should be free and fairly competitive with other insurance carriers which became part of the mission of the Fund. Ms. Quintana further pointed out that State Fund has been necessary in the marketplace and its market share has fluctuated over the years from 10 to 40 percent depending on economic conditions and the situation in the workers’ compensation industry.

James Neary, Vice President and Actuary of the State Compensation Insurance Fund

Mr. Neary also commented on the need for State Fund in the marketplace. He stated that in the current marketplace which is strained, the State Fund’s role is to guarantee availability and affordability of workers’ compensation insurance to employers in California. He also noted that as prices in the marketplace increase, it will attract new entrants and a viable private market will again reappear in California.

Commissioner Steinberg asked how State Fund has managed to maintain such a good record

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while many other insurers have been taken over by the California Department of Insurance. Mr. Neary replied that during open rating the State Fund's price level was higher than other insurance carrier and it was committed to strong reserves.

Chairman Rankin asked if in Mr. Neary's opinion, the employers were paying too much for workers' compensation insurance under the Minimum Rate Law and if the employers are doing better currently. Mr. Neary commented that under the Minimum Rate law there was price competition as well as in open rating. However, the competition under the Minimum Rate Law came in the back end in the form of policyholder dividends, because up front pricing was not allowed as in open rating.

Mark Johnson, Division of Workers' Compensation Audit Unit

Mr. Johnson presented a summary of the audit results for the last five years with indicators of claims handling performances. Mr. Johnson pointed out that the average number of unpaid indemnity per claim has increased between 1997 and 2001. The frequency of late temporary disability payments has also increased during the same period and now payment is made late on about 3 out of 10 claims. The frequency of late payments on medical/legal bills on which there is a requirement to pay or object to medical bills within 60 days is about 9% in 2001.

Commissioner Schwenkmeyer asked why the frequency differed between late payments of temporary disability and payments on medical bills. Mr. Johnson replied that in medical bills there was a larger time frame in which to make the payment. Specifically, in temporary disability cases there is only 14 days from the date of injury when the payment has to be made. However, for the medical bills there is 60 days to make a payment from the date the bill is received.

Chairman Rankin commented that it would be useful to find out if the open rating law and the predatory pricing that went along with it had a significant effect on the way insurance companies paid workers and medical providers.

Glenn Shor, Policy, Program Evaluation and Training Unit of the Division of Workers' Compensation

Mr. Shor commented on the recommendations made by the Workers' Compensation Rate Study Commission created by the Legislature in 1992 to study the rate system in workers' compensation. Mr. Shor noted that two of the recommendations of the Commission were not adopted. One recommendation was to abolish the existing minimum rate law, replacing it by open competition with floor rates approved by the Insurance Commissioner based on loss costs provided by the Workers' Compensation Insurance Rating Bureau. Another recommendation was that the Commissioner of Insurance issue an annual report evaluating the state of competition in the workers' compensation insurance market. Mr. Shor mentioned that such studies are done in several other states including Michigan and Maine which have made the transition to open rating.

Mr. Shor then spoke about various innovations developed by states to improve competition as well as verify coverage. He noted that the State of Missouri publishes all workers' compensation

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insurance premium rates by company and by workers' compensation classifications on their Department of Insurance website. Texas has on their website an ability to verify workers' compensation coverage for an individual employer.

Richard P. Gannon, Administrative Director of the Division of Workers' Compensation (DWC)

Mr. Gannon commented that the solvency and profitability of the insurance industry impacts DWC's responsibility to protect the interests of the injured workers entitled to timely payment and provision of compensation. He emphasized it is important to study if the problems which the insurance industry is faced with are impacting the timeliness of payments to injured workers.

He also stated that new audit procedures will be adopted under the new pending legislation. There will be a need to monitor this transition and see if new audit processes increase the correct and timely payment of benefits.

Commissioner Davenport turned to David Bellusci of the WCIRB and asked if there is a way to study if companies which are avoiding payments to injured workers are the same companies which are becoming insolvent. Mr. Bellusci replied that this can be looked in to.

Gilbert Stein, President-Elect, California Applicants' Attorneys Association (CAAA)

Mr. Stein stated that the position of CAAA is that the elimination of the minimum rate law was a positive thing. He stated that the minimum rate law encouraged inefficiencies in the operation of claims and an open rating system with competition should lead to better claims handling practices. He also mentioned that there should be more oversight at the Insurance Commissioner's Office, because of the concern over possible criminal activities with companies that have gone insolvent.

Mr. Stein proceeded to talk about his concerns of how insurance insolvencies related to delays in timely payments to injured workers. Mr. Stein commented that the Commission should look at this issue and noted that currently there are problems in obtaining claim information which occurs when there is an insolvency and CIGA takes over. He commented that the Commission should look at how to facilitate the smoother transition between a bankrupt company and CIGA. Mr. Stein also voiced concern over delays in cases of cumulative trauma where CIGA is involved.

Rick Wooley, Treasurer, California Applicants' Attorney Association

Mr. Wooley also expressed concerns over delays in cases where CIGA is involved. He commented that there can be as much as eight weeks in delay of benefits to injured workers when the file goes from the insolvent carrier to CIGA and then to the company that is contracted to take over the administration of the claim.

Mr. Wooley also noted that there are delays in getting representation at the Board level for the people who have taken over the administration of the claims through CIGA. This also ultimately leads to a delay in benefits for the injured worker.

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Proposal: Commission Strategic Planning Meeting

Christine Baker, CHSWC Executive Officer

Ms. Baker reported that several Commission members have suggested that it might be useful to conduct a strategic training and planning session at an offsite location, perhaps in July 2002. CHSWC staff would arrange for a facilitator to guide the members and staff in this endeavor. Ms. Baker asked if the Commission wished to proceed on this. After some discussion, the Commission agreed to have the retreat on July 15 and 16.

Proposal: Study of Labor Code Section 132a

Charles Lawrence Swezey, CHSWC Legal Consultant

Commissioner John C. Wilson has requested that the CHSWC consider a study of Labor Code Section 132a and related court decisions regarding medical benefits with respect to a possible conflict with the Education Code. Consultant Larry Swezey prepared a background memo and presented a summary of the issue. After some discussion Chairman Rankin suggested that CHSWC convene a group to obtain more background information on Labor Code Section 132a.

Public Comment

Mary Ann Weathers, Safeway Inc, suggested that CHSWC include employers in the group to examine the Labor Code 132a issue.

Inpatient Hospital Fee Schedule and Outpatient Surgery Study

Christine Baker, Executive Officer

Dr. Gardner/Dr. Kominski report on the Inpatient Hospital Fee Schedule and Outpatient Surgery Study

Ms. Baker reported that the CHSWC staff are recommending the release of the Dr. Gardner/Dr. Kominski report to the public on the Inpatient Hospital Fee Schedule and Outpatient Surgery Study.

Commissioner Steinberg questioned the release of the Gardner/Kominski report due to the controversy over the report by several parties. Ms. Baker replied that the staff addressed those concerns by conducting additional research and putting together a staff report, which included some of the recommendations of Drs. Gardner and Kominski. The staff report does not include the Gardner/Kominski recommendations where more data would need to be collected.

CHSWC Vote on the Gardner/Kominski Report

Commissioner Dulich and Commissioner Schwenkmeyer moved to release to the public the report prepared for the Commission by Dr. Gerald Kominski and Dr. Laura Gardner. It was noted that while parts of the report may be controversial, the release of the report does not carry

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with it approval or disapproval of any elements of the report. Commissioner Wilson seconded and the motion passed unanimously.

CHSWC Summary – Findings and Recommendations from the Inpatient Hospital Fee Schedule and Outpatient Surgery Study

Ms. Baker reported that since the last CHSWC meeting, several meetings were held with CHSWC staff, selected DWC staff, Dr. Kominski, Frank Neuhauser, and representatives from California Health Care Association and Medtronic Sofamor Danek to address their concerns about the inpatient hospital fee schedule and outpatient surgery study.

CHSWC staff analysis and recommendations are included in a supplemental report entitled "CHSWC Summary – Findings and Recommendations from the Inpatient Hospital Fee Schedule and Outpatient Surgery Study". Included in the CHSWC staff Summary report is the recommendation for the inpatient part of the study that

"A joint task force consisting of CHSWC (if the Commission chooses to include the Commission), Division of Workers' Compensation (DWC), California Healthcare Association, other hospital representatives and an OSHPD representative could be established to recommend a reimbursement methodology for high-technology hardware and/or instrumentation for spine surgery DRGs that will provide predictability, stability, efficiency, and access to care." (and others)

In addition, Ms. Baker commented that findings and recommendations from further research conducted by CHSWC staff regarding the outpatient surgery facility fee schedule are included in the Summary report. Some of the recommendations from the report include that a fee schedule which covers outpatient surgery facility fees should be implemented in California and that a fee schedule which covers emergency room facility fees should also be considered.

Public Comment

Sherreta Lane of the California Healthcare Association stated that the Association strongly supports the recommendation of the CHSWC staff summary report to form a joint task force. Ms. Lane thanked the CHSWC staff for all of the work with the Association over the past weeks to look at the reimbursement issue on spinal implants.

CHSWC Vote

Commissioner McLeod moved to approve and release the CHSWC Staff Summary report on the CHSWC study of the Inpatient Hospital Fee Schedule and Outpatient Surgery Study to the DWC Administrative Director and the community. Commissioner Davenport and Commissioner Wilson seconded and the motion passed unanimously.

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CHSWC Study of DWC Judicial System by RAND

Richard P. Gannon, DWC Administrative Director

Mr. Gannon commented on the Draft Report of the Judicial Study prepared for CHSWC by RAND. Mr. Gannon said that the study gives the administrative director as well as the chair of the Workers' Compensation Appeals Board an opportunity to examine the judicial system from various points of view. The study gives a variety of recommendations to assist with the significant improvements and changes that will be necessary.

The DWC Administrative Director also noted that he was impressed with the draft report and its thoroughness and that it would provide DWC with the opportunity to make significant improvements and changes to the judicial system.

Commissioner Wilson asked if it would take new legislation to implement the recommendations of the report. Mr. Gannon replied that DWC would work through the recommendations in the report and put together a Budget Change Proposal to be able to implement them.

CHSWC Vote

Commissioner Davenport moved that CHSWC support the recommendation that the state provide adequate funding so that the Division of Workers' Compensation could implement the recommendations of the study. Commissioner Dulich seconded and the motion passed unanimously.

Proposal: Potential Implementation of AB 749

Christine Baker, Executive Officer

Ms. Baker commented that the CHSWC staff have reviewed AB 749 and noted that there are several new mandates for CHSWC. If AB 749 were to be signed into law by the Governor, CHSWC would need to make preparations to handle the new mandates and increased workload.

Ms Baker requested the Commission's authority for staff to proceed with the necessary planning and paperwork if AB 749 becomes law.

CHSWC Vote

Commissioner Davenport moved to approve the request of the Commission's authorizing CHSWC staff to prepare for the potential new mandates and increased workload for CHSWC in AB 749. Commissioner Schwenkmeyer and Commissioner Dulich seconded and the motion passed unanimously.

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Trends in Earnings Loss from Disabling Workplace Injuries in California: The Role of Economic Conditions

Robert Reville, PhD, Institute for Civil Justice, RAND

Mr. Reville noted that he has provided the Commission with 100 copies of the report entitled "Trends in Earnings Loss from Disabling Workplace Injuries in California: The Role of Economic Conditions". Mr. Reville also noted that the report is available on RAND's website.

Disciplinary Procedures of the Industrial Medical Council

Christine Baker, Executive Officer

Ms. Baker stated that CHSWC has done preliminary staff work in response to a question from Commissioner Allen Davenport regarding disciplinary procedures of the Industrial Medical Council. CHSWC staff recommends that the IMC be invited to make a presentation on its disciplinary procedures at the next Commission meeting in April 2002. Commissioner Davenport added that the IMC should also include in their presentation what the Industrial Medical Council can do to improve the current situation regarding disciplinary procedures.

Adjournment

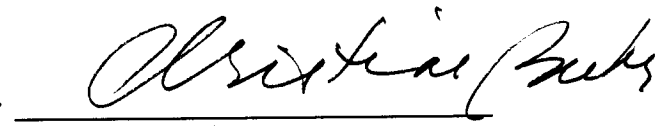
Commissioner Dulich moved to adjourn the meeting. Commissioner Schwenkmeyer and Davenport seconded and the motion passed unanimously.

Approved:

Respectfully submitted,


Tom Rankin, Chair

Date


Christine Baker, Executive Officer